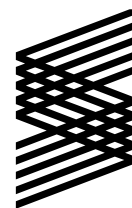


How do African SMEs respond to climate risks? Evidence from Kenya and Senegal

Working paper



PRISE

Pathways to resilience
in semi-arid economies

Research for climate-resilient futures

How do African SMEs respond to climate risks? Evidence from Kenya and Senegal

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Abstract

This paper provides results from a new survey on the adaptation behaviour of small and medium-sized enterprises (SMEs) in Kenya and Senegal. We collect data from 325 SMEs in the semi-arid regions of Kenya and Senegal and use this information to estimate the quality of current adaptation measures, distinguishing between sustainable adaptation and reactive coping.

The firms we surveyed are heavily exposed to climate risks and they employ a range of strategies to deal with them. Some of the measures aim to maintain business continuity (what we call sustainable adaptation), but others are mere coping strategies to ward off the worst impacts of a disaster. The more frequent the occurrence of extreme events, the more the balance shifts toward such reactive coping. This suggests there may be limits to the effectiveness of sustainable adaptation, which necessitates the role of public policy in facilitating good adaptation.

In particular, we find that financial barriers and insufficient market access increases the probability of reactive coping practices, while access to information, general government support and specific adaptation assistance all increase the probability of sustainable adaptation. Since engaging in adaptation today also increases the likelihood that a firm is preparing for future climate change, alongside the ministries of environment and agriculture, Ministries of Finance from both the countries need to involve in developing the drivers of, and in reducing the barriers to, sustainable adaptation strategies. Finally, our findings lend support to the strategy of many development agencies who use adaptation to current climate variability as a way of building resilience to future climate change.

1. Introduction

Humans are able to thrive in a wide range of climate conditions, but we also know that climatic factors, and climate extremes, can have a strong bearing on economic performance (Dell et al. 2012; Noy 2009). Understanding and managing the link between climate and the economy is therefore an important facet of economic development. The concern is heightened by anthropogenic climate change, which could lead to a shift in climate regimes not observed for millennia (Fankhauser and Stern 2017). Some countries may already feel the impact of growing climate anomalies.

A central issue in the climate-economy debate is the extent to which economic agents are able to adapt to climate stress. More optimistic researchers emphasize the aptitude of economic agents, such as farmers, to adjust their production techniques to different climate conditions (e.g., Seo et al. 2010, Seo and Mendelsohn 2008, Wang et al. 2010). More cautious commentators point to a long list of economic, institutional and behavioural barriers, which may prevent effective adaptation (Repetto 2008; Moser and Ekstrom 2010; Berkhout 2012; Sobel and Leeson 2006). Economic agents in developing countries are believed to be particularly constrained in their ability to adapt. This lack of adaptive capacity is sometimes called the adaptation deficit (e.g. Fankhauser and McDermott 2014, 2016).

Adaptive capacity is hard to measure, and we know correspondingly little about the ability of firms in developing countries to respond to climate stress. Much of the relevant literature has focused on the private sector in developed countries (e.g., Linneluecke et al. 2013; Agrawala et al. 2011) and on larger firms (e.g., Averchenkova et al. 2016). Yet the enterprise landscape in developing countries is dominated by small and medium enterprises (SMEs). In sub-Saharan Africa SMEs employ 80 per cent of the workforce (Dougherty-Choux et al. 2015). Smaller firms are thought to have a lower ability to deal with climate risks (Yoshida and Deyle 2005; Runyan 2006; Wedawatta et al. 2010).

Against this backdrop, this paper provides new evidence on the adaptation behaviour of SMEs in Africa. We conduct a survey of 325 SMEs in the semi-arid regions of Kenya and Senegal, helping to overcome the dearth of primary information about firm-level adaptation in low and lower middle-income countries. Semi-arid lands provide a particularly pertinent context for adaptation analysis, given their high exposure to climate stress, the fragility of their economies and the prevalence of small and often informal enterprises, many of which are linked to agriculture (Jobbins et al. 2016).

The paper also makes a methodological contribution by distinguishing explicitly between different types of adaptation. Survey respondents were asked to identify the various forms of adaptation in which they engage and which are then grouped into different categories. A first distinction is made between sustainable forms of adaptation (e.g., changing the product mix), which seek to maintain business operations at existing levels, and reactive coping strategies (such as the distress sale of assets), as part of which business activity is scaled back. A second distinction is between adaptation (sustainable or reactive) to current climate risks and planning for future climate change.

We use econometric techniques to identify how different forms of adaptation interact and how this depends on internal firm characteristics and the external business environment. Specifically, we use a bivariate probit model to estimate the simultaneous probabilities of sustainable adaptation and reactive coping practices. We use an ordered probit model to capture how future adaptation planning depends on the way in which firms currently deal with climate stress. To our knowledge this is the first empirical study to explore the connections between different forms of adaptation in this way.

The analysis produces some highly policy-relevant results. Unsurprisingly, the prevalence of weather extremes increases the probability of adaptation action by SMEs – whether sustainable or reactive. But we also find that the probability of responding positively depends on business-external factors that can be shaped through public policy. We find that insufficient market access and financial barriers lower the probability of sustainable adaptation and increase the probability of reactive coping, while good information, general government support and specific adaptation assistance increase the probability of sustainable adaptation and reduce the probability of

reactive coping. We also find that firms that are currently engaging in adaptation behaviour are more likely to plan ahead and prepare for future climate change, although these efforts are held back not least by insufficient climate information.

The content of the remainder of the article is as follows. Section 2 puts the paper in the context of the existing literature on the adaptation behaviour of firms. Section 3 describes the data collection effort and survey instrument. Section 4 introduces the econometric methodology. Section 5 discusses the results, and section 6 concludes.

2. The adaptation behaviour of firms

For many entrepreneurs, the ability to read and respond to climate signals is essential to commercial success. Farmers, construction companies, hotel operators, electricity suppliers and retailers all adjust their business models to suit the local climate. The most basic economic model (formalized by Mendelsohn 2012) is that of private agents who maximize their profit as a function of climatic conditions.

The literature increasingly seeks to unpack the detailed drivers that motivate economic agents to adapt or prevent them from doing so (Averchenkova et al. 2016; Hertin et al. 2003; Lonsdale et al. 2010; Agrawala et al. 2011; Galbreath 2011; Berkhout 2012; Ballard et al. 2013; Linnenluecke et al. 2013; PWC 2013). While the primary motive of firms may be to keep down costs, minimize disruptions or increase sales, the way the relevant decisions are taken is influenced by a range of additional factors. They can be grouped broadly into firm-internal features and business-external issues (see Table 1).

Table 1: Key factors affecting the adaptation decisions of firms

Internal factors
Salience: (Perceived) importance of climatic factors to business success; presence of a climate change leader/champion within the business
Management structure: Internal decision making processes; seniority of climate champions; access to senior management; length of planning horizon
Capacity: Relevant knowledge, skills and expertise amongst employees; sufficient resources, including financial resources
Information: Availability of relevant resources including data, knowledge and information
External factors
Market drivers: Tangible business risks or new opportunities related to climate factors
Business environment: Administrative barriers, rule of law (e.g. clear land titles), access to finance
Policies: Appropriate incentive structures to encourage climate resilience (e.g. through planning rules, building standards) and prevent moral hazard
Advisory services: Availability of advice and technical assistance, for example via business associations or through extension services

Source: Authors' own

2.1. Firm-internal factors influencing adaptation decisions

The importance which firms assign to climate resilience is influenced by business strategies, management priorities and risk perceptions. In sectors such as agriculture, water, insurance and consulting there is evidence that larger firms are beginning to recognize the effective management of the risks from climate change and climatic extremes as a source of future competitive strength (Surminski 2013; PWC 2010; Agrawala et al. 2011; CDP 2012). However, in many instances, adaptation still lacks the salience to attract senior management attention (Berkhout 2012).

Decisions about climate risks are made through a firm's existing management structure. Particularly in smaller firms these processes are affected by capabilities and resources. SMEs in developing countries often suffer from a lack of skilled labour and low managerial and technical capacity that affect not just adaptation decisions but business success more generally (Hampel-Milagrosa et al. 2015). Other factors influencing SME development include education, experience, social capital, gender, ambition and the owner's risk-readiness. Again, these issues also shape adaptation decision making.

Individual decisions may be affected by behavioural traits. The short planning horizon of many firms can impact the willingness of their managers to invest in longer-term adaptation measures (Trabacchi and Mazza 2015). Planning for climate change requires the ability to make complex decisions under conditions of deep uncertainty, since the future climate largely is unknown. Businesses find this difficult (Ballard et al. 2013). When faced with such intricate problems individuals often encounter cognitive barriers (Grothmann and Patt 2005).

Businesses of all sizes thus need internal knowledge, skills and resources to deal with climate risk, and the characteristics of a business, including its size and type, may affect their ability to adapt. The lack of relevant knowledge, insufficient resources and inadequate expertise within a company will constrain their ability to invest in adaptation action (Lonsdale et al. 2010; PWC 2010; Agrawala et al. 2011; Ballard et al. 2013; Crawford and Seidel 2013).

2.2. Adaptive capacity and the business environment

The ability of firms to deal with climate risks is also affected by the external environment. Market forces will be a key driver of adaptation action, as firms manage business continuity risks, monitor their supply chains, respond to changing demand and develop new products and services (Agrawala et al. 2011; Surminski 2013).

However, for many firms distorted economic incentives (e.g., subsidies on inputs like seeds, fertilizer or irrigation water) and a poor business environment constrain their ability to respond to climate risks or take advantage of new opportunities (Agrawala et al. 2011; Begum and Pereira 2015; OECD 2015; Ballard et al. 2013).

There is an overlap between the business environment that firms face, which affects growth prospects in general, and their ability to adapt to climate risks. Factors like solid institutions, a strong skill base, well-functioning public services and access to credit have a strong bearing on both (Fankhauser and McDermott 2014; Tol and Yohe 2007; Yohe and Tol 2002). For example, Di Falco et al. (2011) find that adaptation levels among Ethiopian farmers vary depending on, among other factors, the availability of credit.

The problems with Africa's business environment are well documented, and they affect SMEs disproportionately (OECD 2007; Stein et al. 2013). Surveys identify poor infrastructure services (in particular, electricity supply, Page and Soderbom 2015) and insufficient access to finance as the main bottlenecks. Using data from the World Bank's Enterprise Survey, Beck and Cull (2014) find that more than 25% of firms in Africa rate the availability and cost of finance as their most important constraint, nearly twice the fraction as outside Africa. Financial constraints are felt particularly keenly by women-owned SMEs and informal SMEs (Bardasi et al. 2007). Another gap in sectors such as agribusiness is insufficient access to technology, knowledge and markets (APPG 2015).

3. Data collection

3.1. The enterprise landscape

To shed further light on adaptation patterns, we collect data on the adaptation behaviour of SMEs in two lower-income countries, Kenya and Senegal. The enterprise landscape of the two countries is fairly typical for sub-Saharan Africa. Across Africa, the private sector is characterized by a large number of micro and small enterprises and a small number of medium and large enterprises. In Kenya, conservative estimates suggest that there are 2.3 million micro and small enterprises, of which about a million are registered. About 10,000 firms are medium-sized (Intellectap 2015).¹

Accordingly, SMEs represent the most realistic employment opportunity for many people, in particular in rural areas (IFC 2004; Baccheta et al. 2009; Dalberg 2011; Edinburgh Group 2013; Dougherty-Choux et al. 2015). In Kenya, SMEs (including micro enterprises) employ around 80% of the workforce and contribute 20% to GDP (Intellectap 2015).

Fewer than 10% of enterprises within the manufacturing sector and with over 10 employees in Kenya and Senegal are owned by women (Bardasi et al. 2007). Female entrepreneurs are largely confined to micro-enterprises and the informal sector, where they have limited growth potential and face significant barriers to their development (Bardasi et al. 2007; Nkakleu et al. 2013; OIT 2016).

A large share of SMEs is in the informal sector. In Senegal, the informal sector contributes to about half of the country's GDP, 90% of jobs and one-fifth of investment (AfDB 2010; Benjamin and Mbaye 2012). In Kenya, the private sector is noticeably split into a formal large-business sector, which is relatively healthy and productive, and a massive, informal small-business sector, which is insufficiently understood and poorly supported, even though it supports the majority of workers (AfDB 2013). According to Intellectap (2015), 90% of Kenyan businesses of all sizes are unregistered and within the SME sector over half of SMEs are part of the informal economy.

The informal sector is particularly dominant in rural areas, including in the key sectors of agriculture, livestock and trade. In Senegal, formal enterprises are mainly concentrated in the large urban areas, with four out of five formal SMEs located in Dakar. Even enterprises with substantial balance sheets sometimes remain in the informal sector because of the poor business environment and burdensome regulations (Benjamin and Mbaye 2012).

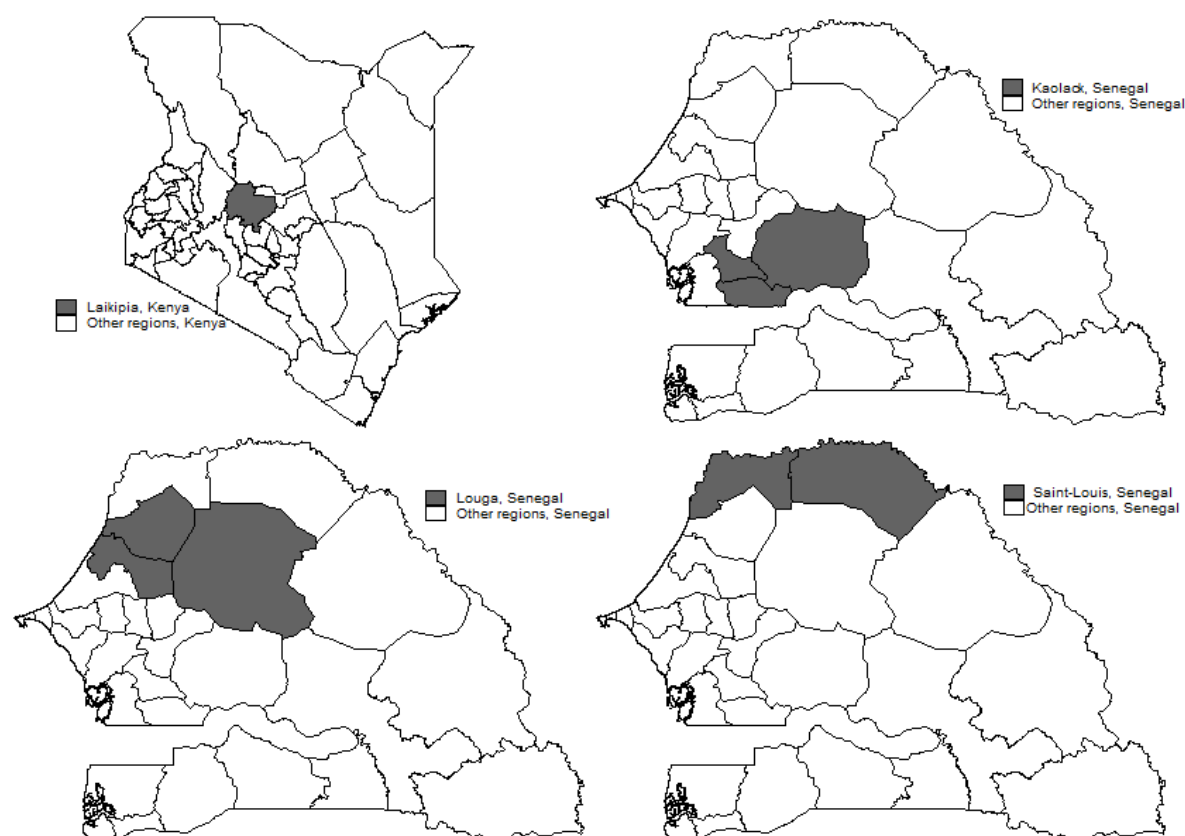
The prevalence of small enterprises and widespread informality are associated with low productivity, reduced competitiveness, poor access to finance and a lack of innovation capabilities (UNIDO and GTZ 2008). While these problems are of concern primarily because of their impact on economic performance, they are also important factors in determining the adaptive capacity of SMEs to climate change risks.

3.2. Survey strategy

The survey was administered in three regions in Senegal and one region in Kenya. Specifically, we interviewed 161 firms in the Louga, Saint Louis and Kaolack regions of Senegal and 164 SMEs in Laikipia County, Kenya (see Figure 1). All four regions have a semi-arid climate and surveyed firms are thus exposed to similar climate risks, including frequent temperature extremes and regular exposure to droughts and floods.

¹The size-definition of SME varies. We follow the definition in the World Enterprise Survey and limit SMEs to firms with 1-100 employees.

Figure 1: Map of surveyed regions from Kenya and Senegal



Source: Authors' own

The survey focused on two sectors that are key to the local economy and characteristic of semi-arid regions: agriculture (including livestock), and trade and processing (focusing on agricultural products, e.g. processing of cereals). Farming employs around 60% of the total labour force in both Kenya and Senegal, and corresponding numbers in the case study regions range from 50% in Laikipia to 78% in Louga.

Table 2: Sampling

Column1	Number of SMEs			
	Total	Micro	Small	Medium
Senegal				
Agriculture	96	37	42	17
Trade and others	65	27	21	17
Total in Senegal	161	64	63	34
Kenya				
Agriculture	81	69	6	6
Trade and others	83	67	9	7
Total in Kenya	164	136	15	13

Source: Authors' own

Table 2 contains a breakdown of the number of SMEs sampled by country, sector and firm size. SMEs were randomly selected, and are representative of the average numbers of SMEs in the surveyed regions. The survey was pilot-tested in both countries,² and implemented by local teams of enumerators who received training ahead of the pilot tests and before full implementation, when instructions were refined. The raw data went through a thorough quality control process, including extensive consistency checks.

²In Senegal, the pilot test covered 8 agricultural and non-agricultural SMEs in Saint Louis and 6 SMEs in Louga. In Kenya, the pilot covered 36 SMEs from both sectors in Laikipia

3.3. The questionnaire

The survey instrument was designed to collect wide-ranging information on numerous aspects of the adaptation behaviour, both with respect to current climate variability and future climate change. As such the survey collected much more data than we will use in this paper. The questionnaire and primary data are available to other researchers via the supplementary materials.

The core of the survey explores the understanding of respondents of climate risks, the measures they take to address these risks, the impacts they think climate change will have on their businesses, the opportunities they have identified and the extent to which they have started planning for climate change.

Table 3: Summary of adaptation measures reported

Adaptation Measures	Frequency in %
Sustainable adaptation	
Get a loan	16.9
Take up insurance	7.3
Switch to a different commodity or crop	20.6
Introduce new commodity or crop	27.6
Switch to a different variety of the same commodity or crop	23.6
One or more of the above	45.2
Reactive coping	
Reduce number of employees	16
Sell assets (not at a loss)	5.3
Sell assets at a loss	8.6
Mortgage / rent out assets	1.7
One or more of the above	25.6
Planning for climate change	
Adaptation planning without support	18.6
Adaptation planning with external support	19.9
One or more of the above	38.5

Note. Total sample size is 301, with 151 and 150 SMEs from Senegal and Kenya, respectively.
Source: Authors' own

The survey also includes questions around the resources that SMEs have available for adaptation and the constraints they face in accessing these resources. We collect data on risk exposure (e.g., number of extreme events), firm-internal characteristics (e.g. ownership structure, including the gender of the owner, employee numbers, etc.) and the external business environment (e.g. markets access, finance and infrastructure). This will allow us to relate adaptation decisions to the economic and business context in which they were taken.

For the purposes of this paper we group the adaptation responses of firms into three categories (see Table 3). Respondents often engage in more than one of these activities:

- The first group of responses covers what we call sustainable adaptation. This includes purposeful measures that are taken to mitigate risks or reduce the impact of a climate event, for example by changing products or taking out insurance.³ Their aim is to maintain business activity at current level to the extent possible.
- The second group, labelled reactive coping, includes measures that are taken in response to a climate event. They involve for example redundancies and/or the sale of assets (e.g., livestock), often at a loss. These measures are unsustainable in the sense that they result in a temporary (and sometimes permanent) reduction in business activity.
- The third group of measures focuses on future climate risks. It includes the planning measures firms take to prepare for climate change. These measures are by their nature forward looking and long term.

³The role of insurance in adaptation is a matter of debate. On the one hand, it is an effective way of risk sharing. On the other hand it can encourage under-adaptation and moral hazard (Surminski 2016).

4. The analytical approach

4.1. Econometric specification

The survey identifies considerable variations in adaptation behaviour, climate risk exposure, firm characteristics and the external business environment. We use this heterogeneity to answer two sets of questions:

- How does the balance between sustainable adaptation and reactive coping shift as a function of current climate stress, firm characteristics and the external environment?
- How does current adaptation behaviour (sustainable or reactive) affect the propensity of firms to plan for future climate change, and how is this propensity to plan affected by firm characteristics and the external environment?

We employ a bivariate probit model to explore the first question. Since SMEs may adopt both sustainable and reactive adaptation measures at the same time, we need a model that consists of a system of equations.⁴ The bivariate probit allows us to simultaneously estimate the probabilities of sustainable and reactive adaptation practices.⁵

The binary dependent variables S_i (defined as 1 if SME i adopts at least one sustainable adaptation measure and 0 if not) and R_i (defined as 1 if SME i adopts at least one reactive coping measure and 0 if not) are determined by two unobserved latent variables, $S_i^* = n_i\alpha_S + x_i\beta_S + z_i\gamma_S + \epsilon_{Si}$ and $R_i^* = n_i\alpha_R + x_i\beta_R + z_i\gamma_R + \epsilon_{Ri}$, where observations are indexed by SME i . The vectors x_i and z_i represent a set of internal firm characteristics and external business environment variables, respectively, and n_i measures the level of climate stress experienced by firm i . The variables are explained in more detail below (see also Table 4). The errors ϵ_{Si} and ϵ_{Ri} are jointly normally distributed with means of 0 and variances of 1, and a correlation of ρ .

We observe the binary outcomes:

$$(1) \quad S_i = \begin{cases} 1 & \text{if } S_i^* > 0 \\ 0 & \text{if } S_i^* \leq 0 \end{cases} \quad \text{and} \quad R_i = \begin{cases} 1 & \text{if } R_i^* > 0 \\ 0 & \text{if } R_i^* \leq 0 \end{cases}.$$

To explore the second question, we use an ordered probit model that captures how future adaptation planning depends on the way in which a firm currently deals with climate stress. Future adaptation planning by firm i , P_i , is characterized by the latent variable $P_i^* = \delta_S\hat{S}_i + \delta_R\hat{R}_i + w_i\delta + \epsilon_i$, where \hat{S}_i and \hat{R}_i are simultaneously estimated probabilities of current sustainable and reactive practices of firm i using specification (1). Vector w_i contains climate change-specific explanatory variables (see below and Table 4). $\forall \mu_{k-1} < P_i \leq \mu_k, k = 0, 1, 2$, we observe the ordered outcomes:

$$(2) \quad P_i = \begin{cases} 2 & \text{if } \mu_1 < P_i^* \leq \mu_2 \\ 1 & \text{if } 0 < P_i^* \leq \mu_1 \\ 0 & \text{if } P_i^* \leq 0 \end{cases},$$

so that $Pr(P_i = k|\Psi) = \Phi(\mu_k - \Psi) - \Phi(\mu_{k-1} - \Psi)$, $\Psi = (\delta_S\hat{S}_i + \delta_R\hat{R}_i + w_i\delta)$, which represents the corresponding marginal effects. The outcome categories are 0 if the SME does not have any future adaptation planning, 1 if the SME plans for future adaption without the help of extension services, and 2 if the SME plans for future adaption with the help of extension services.

4.2. Definition of variables

Table 4 describes and summarizes the outcome and explanatory variables that we use in specifications (1) and (2). Table 5 documents how firm-internal and external characteristics differ between firms that do and do not engage in adaptation.

⁴In particular, 57 out of 301 SMEs simultaneously adopted at least one sustainable adaptation strategy and at least one reactive coping strategy.

⁵We also estimate the probabilities of sustainable adaptation and reactive coping using separate probit regression models. The results are consistent with our preferred specification, the bivariate probit model.

Table 4: Variable description and summary statistics

Variables	Description	Mean	S.D.	Min.	Max.
Sustainable adaptation	1 if the SME adopted at least one sustainable practice, 0 if otherwise	0.452	0.499	0	1
Reactive coping	1 if the SME adopted at least one coping practice, 0 if otherwise, 0 if otherwise	0.256	0.437	0	1
Planning for climate change	1 if the SME is planning for adaptation to future climatic risks (with or without external help), 0 if otherwise	0.385	0.487	0	1
Number of climate extremes		1.862	1.485	0	10
Trained Entrepreneur	1 if the interviewed entrepreneur is professionally trained, 0 if not	0.618	0.487	0	1
Male entrepreneur	1 if the interviewed entrepreneur is a male, 0 if female	0.691	0.463	0	1
Family ownership	1 if the SME is privately or family-owned, 0 if otherwise	0.754	0.431	0	1
Size of the SME	Total number of workers in the SME	10.007	16.734	1	100
Sector of the SME	1 if agricultural SME, 0 if non-agricultural	0.545	0.499	0	1
Financial barriers	1 if the SME encountered financial barriers when adapting to climatic risks, 0 if otherwise	0.781	0.414	0	1
Access to information	1 if the SME has access to internet connection, 0 if otherwise	0.385	0.487	0	1
Membership	1 if the SME is a membership of a professional organization, 0 if otherwise	0.611	0.488	0	1
Distance to market	Distance from the nearest marketplace (in kilometers)	5.318	7.456	0	42
Location	1 if the SME is located in rural areas, 0 if urban	0.581	0.494	0	1
General support	1 if the SME received government subsidies, 0 if not	0.266	0.442	0	1
Adapt. assistance	1 if the SME received support when adapting to climatic risks, 0 if otherwise	0.498	0.501	0	1
Lack of salience	1 if climate change is not recognized as an immediate priority for the business/SME, 0 if otherwise	0.661	0.474	0	1
Lack of climate data	1 if there is lack of relevant climate data specific to business/SME, 0 if otherwise	0.738	0.44	0	1

Notes. Total sample size is 301, with 151 and 150 SMEs from Senegal and Kenya, respectively.

Source: Authors' own

Table 5: Mean comparison of explanatory variables with and without a response to climatic risks

	(1)	(2)	(3)	(4)	(5)	(6)
	Sustainable adaptation		Reactive coping		Future planning	
Variables	Yes	No	Yes	No	Yes	No
Number of climate extremes	2.118	1.648	2.364	1.688	2.054	1.868
	(1.420)	(1.510)	(1.708)	(1.361)	(1.689)	(1.518)
Trained entrepreneur	0.699	0.552	0.662	0.603	0.571	0.589
	(0.461)	(0.499)	(0.476)	(0.490)	(0.499)	(0.493)
Male Entrepreneur	0.669	0.709	0.779	0.661	0.732	0.692
	(0.472)	(0.456)	(0.417)	(0.475)	(0.447)	(0.463)
Family ownership	0.735	0.77	0.818	0.732	0.75	0.708
	(0.443)	(0.422)	(0.388)	(0.444)	(0.437)	(0.456)
Size of the SME	9.081	8.727	5.974	9.888	8.696	9.53
	(16.07)	(16.16)	(12.39)	(17.09)	(17.11)	(15.87)
Sector of the SME	0.632	0.473	0.597	0.527	0.482	0.53
	(0.484)	(0.501)	(0.494)	(0.500)	(0.504)	(0.500)
Financial barriers	0.809	0.758	0.935	0.728	0.786	0.784
	(0.395)	(0.430)	(0.248)	(0.446)	(0.414)	(0.413)
Access to information	0.463	0.321	0.506	0.344	0.571	0.276
	(0.500)	(0.468)	(0.503)	(0.476)	(0.499)	(0.448)
Membership	0.581	0.636	0.558	0.629	0.536	0.616
	(0.495)	(0.483)	(0.500)	(0.484)	(0.503)	(0.488)
Distance to market	6.441	4.394	7.013	4.741	4.92	5.092
	(8.281)	(6.584)	(8.871)	(6.835)	(7.189)	(7.101)
Location	0.669	0.509	0.74	0.527	0.643	0.562
	(0.472)	(0.501)	(0.441)	(0.500)	(0.483)	(0.497)
General support	0.36	0.188	0.286	0.259	0.268	0.243
	(0.482)	(0.392)	(0.455)	(0.439)	(0.447)	(0.430)
Adapt. assistance	0.64	0.382	0.636	0.451	0.554	0.443
	(0.482)	(0.487)	(0.484)	(0.499)	(0.502)	(0.498)
Lack of salience	0.654	0.667	0.494	0.719	0.625	0.692
	(0.477)	(0.473)	(0.503)	(0.451)	(0.489)	(0.463)
Lack of climate data	0.763	0.718	0.766	0.729	0.643	0.781
	(0.427)	(0.451)	(0.426)	(0.446)	(0.483)	(0.414)
Observations	136	165	77	224	56	185

Source: Authors' own

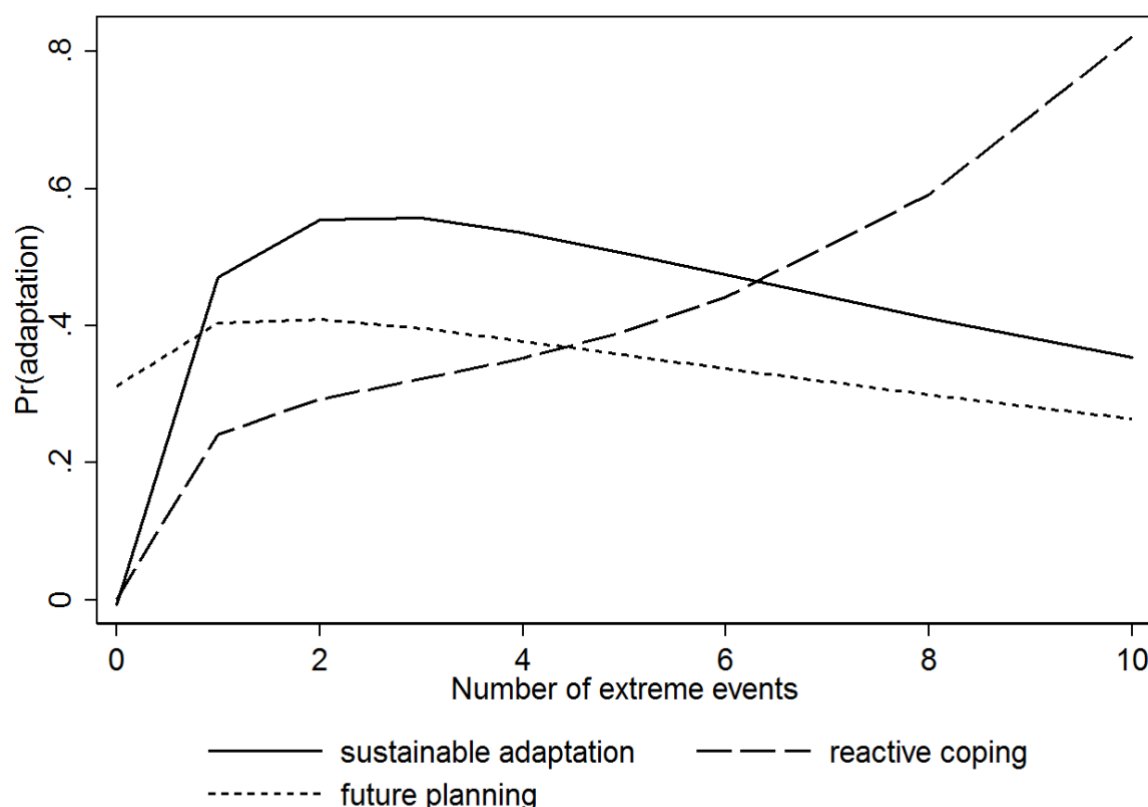
The dependent adaptation variables S_i and R_i take a value of 1 if a firm has adopted at least one of the corresponding measures listed in Table 3 and 0 otherwise. The planning variable P_i takes values of 0, 1 or 2 as defined in equation (2).

Exposure to climatic risks is measured by the number of climatic extremes, (n_i), experienced by an SME in the last 3 years. Surveyed firms report on their exposure to droughts, flood, extreme rainfall, extreme temperature, and extreme wind and dust storms. Although self-reported exposure data can be a weak proxy for climatic risk – events are misremembered (Guiteras et al. 2015) – pairwise correlation coefficients confirm that n_i is uncorrelated to the components of vectors \mathbf{x}_i and \mathbf{z}_i . Therefore, the possibility of over- or under-reporting of exposure to climatic extremes is random.⁶

In addition to n_i , the regressions also include the squared number of climatic extremes, n_i^2 , to control for the potential non-linearity in the relationship between adaptation and exposure as shown in Figure 2.

⁶The survey also includes various measures of climate impacts, such as the amount of damage caused, which are related to the intensity of an event. Having a measure of event intensity would in principle be desirable. However, unlike the number of events, the damage indicators are also a function of adaptation and as such endogenous.

Figure 2: Unconditional relationship between the probability of different types of adaptation and the number of extremes events



Source: Authors' own

Tables 3 and 4 confirm the high exposure to climate risks: on average, the surveyed SMEs recall close to two climate extremes, with $n \in [0,10]$. Adapting firms experience substantially higher climate risks (Table 5), but only 45.2% of surveyed SMEs have adopted some sustainable adaptation measures while 25.6% resorted to reactive coping; 38.5% SMEs have started planning for climate change. The most frequent adaptation response is an adjustment in the commodities or crops produced, while one in six firms had to make staff redundancies (Table 3).

The vector on firm and entrepreneur-specific characteristics (\mathbf{x}_i) includes variables on skills (training) and organizational capacity (measured through firm size – the logged number of employees). The vector also includes the gender of the entrepreneur and variables on ownership and sector of activity (agriculture and non-agriculture). Table 4 reports that the surveyed firms employ 10 workers on average. Just over half operate in the agriculture sector and three quarters of them are either family owned or privately owned. Just over two thirds of individual respondents (e.g., managers or owners) were male, and slightly fewer have received professional training.

The vector for the external environment (\mathbf{z}_i) includes contextual factors that influence a firm's ability and willingness to adapt, such as the presence of financial barriers and access to information in the form of an internet connection or subscription to a newspaper. Access to markets and associated business networks is measured through membership of a professional organization and distance from market (in kilometres). We also include a dummy on rural location. We do not include the quality of infrastructure, a variable that features prominently in business environment surveys, but is not usually seen as a determinant of adaptive capacity (Fankhauser and McDermott 2014; Tol and Yohe 2007; Yohe and Tol 2002).

Table 4 reports that just over three quarters of SMEs face financial barriers limiting their ability to adapt. Two out of five SMEs have access to information sources, though there is a noticeable difference between adapting and non-adapting firms (Table 5). Three out of five firms are located in rural areas, with an average distance of 5.3 kilometres from the nearest market place. Surprisingly, remote, rural SMEs appear to be more likely to adapt than

those closer to markets (Table 5), contradicting earlier evidence of rural-urban differences in climate impact (Burgess et al. 2013).

The vector \mathbf{z}_i further includes variables on a firm's access to external support, including general support, which covers input subsidies from government, and adaptation assistance, which documents any kind of adaptation support from national government, local government, NGOs and friend and family.⁷ Table 4 reports that about a quarter of firms enjoyed general government support and half of them received adaptation assistance (financial, technical or material). External support is more prevalent among adapting firms than non-adapting firms (Table 5), although the causality of this relationship is unclear.

The vector \mathbf{w}_i includes two factors that specifically affect a firm's willingness or ability to plan for climate change. Lack of salience records whether the entrepreneur considers climate change to be threats to their business. Lack of data documents whether the entrepreneur has access to information on climate change, that is, it tests whether firms have the knowledge base for informed adaptation planning. Of the surveyed SMEs, two thirds do not recognize climate change as an immediate priority and three quarters report the lack of relevant climate data specific to business/SME.

Finally, we include a district fixed effect, which controls for unobserved differences among locations both within a country and between regions in Kenya and Senegal.

⁷In an extended specification, we additionally interacted number of extremes with the components of the vector \mathbf{z}_i . Results are similar; therefore, we do not include them in the reported results.

5. Results

5.1. Overview

We next turn to the results. Table 6 reports the results of the bivariate probit specification (equation 1). Statistically significant value of ρ suggests the presence of simultaneity, justifying the use of the bivariate probit model; whereas statistically significant χ^2 value suggests that the regressors are jointly significant, and, therefore, the model is correctly specified.

Table 6 reports both the absolute effects (columns 1 and 2) and the marginal effects (columns 3–6) of explanatory variables on the simultaneous choices of sustainable and reactive adaptation practices. We use the notations $P11 = \Pr(\text{sustainable}=1, \text{reactive}=1)$, $P10 = \Pr(\text{sustainable}=1, \text{reactive}=0)$, $P01 = \Pr(\text{sustainable}=0, \text{reactive}=1)$ and $P00 = \Pr(\text{sustainable}=0, \text{reactive}=0)$. The predicted probabilities of each of the four cases evaluated at the mean value of the explanatory variables are very close to the corresponding sample frequencies, further validating our fitted models (Cameron and Trivedi 2010): 48% SMEs do not adapt at all, 7% engage in reactive coping only, 26% only adopt sustainable practices, and 19% adopt both sustainable and reactive practices.

Table 7 contains the equivalent results for the second econometric specification (equation 2), which estimates the probability of adaptation planning for future climate change. We use the results of tables 6 and 7 to test a number of hypotheses.

5.2. Adaptation behaviour as a function of climate risk

The first hypothesis we explore concerns the association between adaptation and climate risk. A priori, we expect to find more adaptation, of any kind, in firms that experience climate extremes more often (as suggested for example in Table 5). We expect the incidence of reactive coping to increase continuously with the number of extreme events, while the use of sustainable adaptation strategies might level off at some point. If so this would signify a limit to sustainable adaptation; under extreme climate stress reactive coping measures become increasingly dominant and unavoidable.

The results bear out these assumptions. Figure 2 shows a positive association between sustainable and reactive adaptation on the one hand, and the number of climate extremes a firm has faced on the other. While the relationship with reactive coping is almost linear, the link between climate stress and sustainable adaptation levels off with firms that have faced three extreme events or more.

Figure 2 is based on the raw data, without controlling for confounding factors. However, the findings are robust to the introduction of controls, using the bivariate probit model of equation (1). According to Table 6, the probability of inaction ($P00$) reduces by 10.1% with every additional extreme event, and the probability of simultaneously adopting sustainable and reactive measures ($P11$) increases by 5.5%. Together with the corresponding absolute coefficients (column 2) this suggests that repeated exposure to extreme events is associated with higher likelihood of an adaptation response.

5.3. Adaptation behaviour and firm characteristics

Our second hypothesis concerns the link between adaptation and firm-internal factors. A priori, we expect higher management skills (such as managers' education) and organizational capacity (linked to firm size) to be associated with more adaptation action overall. We also expect capacity and skills to be associated with a preference for sustainable adaptation and less reactive coping at the margin.

Against expectation, our analysis is unable to validate these assumptions. We find a positive relationship between adaptation action (both sustainable and reactive) on the one hand and skills and capacity on the other (Table 6). In terms of marginal effects, we find that trained entrepreneurs rely more heavily on sustainable adaptation ($P11$, $P10 > 0$) and larger firms resort less to coping measures ($P11$, $P01 > 0$).

Table 6 further suggests that family ownership reduces the probability of sustainable adaptation ($P11, P10 < 0$). This might suggest that external managers have a stronger grasp of adaptation, but the statistical significance is weak.

We find that male entrepreneurs are more active on adaptation overall, but not significantly so. At the margin, men are more likely to adopt coping strategies ($P11, P01 > 0$) and perhaps less likely than women to engage in sustainable adaptation ($P11 + P10 < 0$). The fact that women-led SMEs might adopt more sustainable adaptation practices is interesting, given that female entrepreneurs often face additional social barriers (Bardasi et al. 2007; Nkakleu et al. 2013; OIT 2016).

Table 6: Current adaptation behaviour: bivariate probit regressions

	(1)	(2)	(3)	(4)	(5)	(6)
	Coefficients		Marginal effects			
Variables	Sustainable adaptation	Reactive coping	P11	P10	P01	P00
Number of extremes	0.578*** (0.144)	0.393** (0.175)	0.055*** (0.013)	0.044** (0.018)	0.002 (0.009)	-0.101*** (0.021)
(Number of extremes) ²	-0.066*** (0.020)	-0.032 (0.024)				
Trained Entrepreneur	0.358* (0.196)	0.319 (0.223)	0.071* (0.036)	0.039 (0.046)	0.001 (0.022)	-0.111** (0.053)
Male Entrepreneur	-0.195 (0.201)	0.437* (0.228)	0.042 (0.037)	-0.102** (0.047)	0.056** (0.024)	0.003 (0.054)
Family Ownership	-0.438* (0.259)	0.18 (0.314)	-0.011 (0.050)	-0.122* (0.063)	0.052 (0.032)	0.082 (0.071)
Ln(SME size)	0.041 (0.095)	0.188* (0.110)	0.028 (0.018)	-0.016 (0.023)	0.014 (0.011)	-0.027 (0.026)
Sector of the SME	0.223 (0.217)	-0.315 (0.251)	-0.024 (0.041)	0.092* (0.051)	-0.047* (0.026)	-0.021 (0.059)
Financial barriers	-0.099 (0.210)	0.853*** (0.308)	0.105** (0.046)	-0.135** (0.054)	0.088*** (0.032)	-0.058 (0.060)
Access to Information	0.491** (0.207)	0.123 (0.239)	0.055 (0.039)	0.095* (0.049)	-0.028 (0.024)	-0.122** (0.055)
Membership	-0.475** (0.196)	-0.286 (0.214)	-0.076** (0.035)	-0.069 (0.045)	0.011 (0.022)	0.134*** (0.051)
Distance to market	0.018 (0.014)	0.056*** (0.016)	0.009*** (0.003)	-0.003 (0.003)	0.004** (0.002)	-0.009** (0.004)
Location	0.08 (0.222)	0 (0.265)	0.006 (0.043)	0.018 (0.054)	-0.006 (0.027)	-0.018 (0.061)
General support	0.556** (0.220)	0.327 (0.244)	0.088** (0.040)	0.082 (0.051)	-0.014 (0.025)	-0.156*** (0.058)
Adaptation assistance	0.576*** (0.185)	0.062 (0.207)	0.054 (0.034)	0.122*** (0.043)	-0.040* (0.021)	-0.136*** (0.048)
Constant	-0.698 (0.701)	-4.775*** (0.937)				
Observations	296	296	296	296	296	296
District dummies	YES	YES	YES	YES	YES	YES
chi2	118.5***	118.5***				
Wald test for $p = 0$	15.64***					

Notes: Standard errors are in parentheses. ***, ** and * represent statistical significance of 1%, 5% and 10%, respectively. We do not report the district dummies here, but coefficients are available upon request. Columns (1) and (2) report the coefficients; whereas (3)–(6) report the corresponding marginal effects based on the equation (1). We denote $P11 = \Pr(\text{sustainable}=1, \text{reactive}=1)$, $P10 = \Pr(\text{sustainable}=1, \text{reactive}=0)$, $P01 = \Pr(\text{sustainable}=0, \text{reactive}=1)$ and $P00 = \Pr(\text{sustainable}=0, \text{reactive}=0)$.

Source: Authors' own

5.4. Adaptation behaviour and the external environment

Our third hypothesis concerns the link between adaptation and the external business context. Based on the literature on adaptive capacity (Fankhauser and McDermott 2014; Tol and Yohe 2007; Yohe and Tol 2002), we expect factors that are conducive for enterprise development (such as access to finance, information, markets and external support) to shift the balance from reactive coping toward sustainable adaptation, while defects in the business environment have the opposite effect.

We find support for these hypotheses. The most striking result is the degree to which financial barriers increase the need for reactive coping (i.e. staff redundancies or the sale of assets). At the same time, access to information, general government support and adaptation assistance dramatically increase the likelihood that firms adopt sustainable adaptation measures (Table 6).

On the marginal effects, we find that remoteness (distance from markets) and financial barriers increase the need for reactive coping, either on their own (P01 is significant and positive) or in conjunction with sustainable adaptation (P11 is significant and positive). The probability that firms will rely on sustainable adaptation alone is lower (i.e., P10 is significant and negative).

Access to information, general government support and adaptation assistance make the complete absence of any adaptation action significantly less likely (P00 is negative and significant). The three factors also increase the probability of sustainable adaptation (P11, P10 > 0), although not all effects are statistically significant.

The results reinforce the importance of creating an enabling environment for adaptation by providing access to finance, information, adaptation assistance and general government support.

5.5. Planning for future climate change

Our final hypothesis concerns planning for future climate change. We expect firms that are actively dealing with current climate stress to be more likely to have started preparations for future climate change. The same factors that encourage adaptation to current climate stress will also encourage planning for future climate change.

Our findings, using the ordered probit model of equation (2), are consistent with this hypothesis. We find that both the extent and quality of current adaptation practices has a significant influence on the probability of future adaptation planning (Table 7). SMEs with current adaptation practices are more likely to have a future adaptation plan, and the probability is higher still for those adopting sustainable adaptation practices. We also find that these firms are more likely to plan for climate change with external assistance from extension services.

Table 7: Future adaptation planning: ordered probit regressions

Variables	(1)	(2)	(3)
	Coefficients	Marginal effects	
		planning without help	planning with help
Sustainable adaptation (est.)	0.359*** (0.101)	0.033*** (0.010)	0.092*** (0.026)
Reactive coping (est.)	0.135** (0.058)	0.013** (0.005)	0.035** (0.015)
Lack of salience	-0.177 (0.153)	-0.016 (0.014)	-0.046 (0.039)
Lack of climate data	-0.315* (0.163)	-0.029* (0.016)	-0.081* (0.042)
Constant cut1	-0.248 (0.170)		
Constant cut2	0.364** (0.171)		
Observations	293	293	293

Notes: Standard errors are in parentheses. ***,** and * represent statistical significance of 1%, 5% and 10%, respectively. Column (1) reports the coefficients; whereas (2) and (3) report the corresponding marginal effects for “Planning without extension services” and “Planning with extension services” based on the equation (2).

Source: Authors' own

Lack of salience, that is, a perception that climate change is not an important priority, increases the likelihood that firms do not engage in adaptation planning. However, the effect is not statistically significant.

In contrast, lack of sufficient climate information and relevant data on climate change (whether real or perceived) is a significant barrier that prevents SMEs from taking proactive action on climate change.

The results are consistent with the literature, which maintains that while businesses have started to recognize the risks and opportunities from climate change, they are constrained in their ability to develop and implement long-term adaptation measures. They often lack the knowledge required for future planning (Trabachi and Mazza, 2015; Begum and Pereira, 2015).

5.6. Robustness checks

Our results are robust to the choice of country sub-samples and alternative definitions of the adaptation variables. The detailed robustness results are reported in appendix Tables A1–A3.

As a first robustness check we run separate bivariate probit regressions (employing equation 1) on sub-samples of Kenyan SMEs and Senegalese SMEs only. The results, as reported in appendix Table A1, are consistent with those reported in Table 6 for the overall sample. However, while the directions and magnitudes of relationships are similar, results from the country sub-samples have less predictive power due to the much smaller sample size. Valid samples are 146 observations for Senegal and 150 observations for Kenya.

Next, we experiment with alternative ways to classify adaptation responses. Instead of distinguishing between sustainable and reactive adaptation, we group adaptation strategies into financial adjustments, capacity adjustments and production adjustments. Financial adjustments include getting a loan, taking up insurance and mortgaging or renting out assets. Capacity adjustments include a reduction in the number of employees and the sale of assets either below or at the market price. Production adjustments cover the switch to a different commodity or crop, introducing a new commodity or crop, and switching to a different variety of the same commodity or crop (see Table 3 above). We employ separate probit regressions to estimate the coefficients for the three types of adaptation (Table A2). The results are weaker but broadly consistent with those in Table 6.

Finally, we simplify the definition of future planning by combining future planning with or without the help of external assistance as single response (Table A3). We then employ a probit regression and find that the results are consistent with the ordered probit regressions reported in Table 7.

6. Conclusions

This paper provides results from a new survey on the adaptation behaviour of SMEs in semi-arid Kenya and Senegal. Statistical information is still rare about the way in which firms in developing countries deal with climate risks. Yet understanding and managing these growing risks is an essential facet of sustainable development.

The firms we surveyed are heavily exposed to climate risks and they employ a range of strategies to deal with them. Some of the measures aim to maintain business continuity (what we call sustainable adaptation), but others are mere coping strategies to ward off the worst impacts of a disaster. The more frequent the occurrence of extreme events, the more the balance shifts toward such reactive coping. This suggests there may be limits to the effectiveness of sustainable adaptation.

There is a clear role for public policy in facilitating good adaptation. The ability of firms to respond to climate risks depends in no small measure on factors that can be shaped through policy intervention. We find that financial barriers and insufficient market access increases the probability of reactive coping practices, while access to information, general government support and specific adaptation assistance all increase the probability of sustainable adaptation.

The benefits are immediate as well as long-term. The more firms engage in sustainable adaptation behaviour, the more likely they are to also start planning for future climate change, thus reducing their long-term vulnerability to climate risk.

While pointing to the importance of public policy, the paper leaves many questions unanswered. Methodologically, our analysis is based on cross-sectional evidence. This makes it difficult to ascertain conclusively the causality of some of the correlations we find. Further analysis with panel data would be desirable to firm up the evidence base. More generally, we are only just beginning to understand the adaptation behaviour of firms, particularly smaller ones and those in developing countries. The survey we introduce in this paper is relatively small and limited to a cross section, but it contains a wealth of additional information that has yet to be explored.

There is a rich research agenda on firm-level adaptation in developing countries. It would be good to know more about the gender aspects of firm-level adaptation, the connection between adaptation behaviour and firm performance, the role that climate risk plays in investment decisions and how climate risks percolate through the supply chain. In policy terms, we need a more systematic evaluation of different government interventions to establish which adaptation policies work best.

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Appendices

Table A1: Current adaptation behaviour in Senegal and Kenya: bivariate probit regressions

Variables	(1)	(2)	(3)	(4)
	Senegal		Kenya	
	Sustainable adaptation	Reactive coping	Sustainable adaptation	Reactive coping
Number of extremes	1.521*** (0.429)	0.835 (0.614)	0.470** (0.184)	0.336 (0.216)
(Number of extremes) ²	-0.262*** (0.082)	-0.139 (0.114)	-0.047** (0.024)	-0.019 (0.028)
Trained Entrepreneur	0.814** (0.398)	0.625 (0.498)	0.317 (0.256)	0.229 (0.284)
Male Entrepreneur	0.212 (0.420)	-0.425 (0.621)	-0.295 (0.266)	0.665** (0.283)
Family Ownership	-0.507 (0.350)	-0.323 (0.472)	-0.390 (0.431)	0.905* (0.493)
Ln(SME size)	0.083 (0.146)	-0.080 (0.203)	0.040 (0.143)	0.396** (0.162)
Sector of the SME	-0.153 (0.457)	-0.474 (0.662)	0.184 (0.277)	-0.482 (0.315)
Financial barriers	-0.105 (0.290)	1.012** (0.515)	-0.415 (0.361)	0.459 (0.439)
Access to Information	0.535 (0.371)	0.168 (0.588)	0.551* (0.292)	0.187 (0.310)
Membership	-0.543 (0.348)	-0.690 (0.442)	-0.391 (0.259)	-0.084 (0.266)
Distance to market	-0.040 (0.030)	-0.009 (0.039)	0.059** (0.023)	0.096*** (0.025)
Location	-0.120 (0.449)	0.011 (0.624)	0.312 (0.297)	0.330 (0.348)
General support	0.812** (0.337)	1.079** (0.478)	0.438 (0.381)	0.130 (0.390)
Adaptation assistance	0.441 (0.301)	-0.274 (0.375)	0.625** (0.269)	0.227 (0.283)
Constant	-0.443 (0.985)	-2.677* (1.381)	-0.757 (0.685)	-4.856*** (1.038)
Observations	146	146	150	150
District dummies	YES	YES	YES	YES

Notes: Standard errors are in parentheses. ***, ** and * represent statistical significance of 1%, 5% and 10%, respectively. We employ equation (1) on the subsamples of SMEs from Senegal and Kenya. Columns (1) and (2) report the bivariate probit coefficients for sustainable adaptation and reactive coping in Senegal; whereas (3) and (4) report the corresponding coefficients in Kenya.

Source: Authors' own

Table A2: Financial, capacity and production adjustments: probit regressions

	(1)	(2)	(3)
Variables	Financial adjustment	Capacity adjustment	Product adjustment
Number of extremes	0.320* (0.170)	0.356** (0.168)	0.441*** (0.147)
(Number of extremes) ²	-0.036 (0.024)	-0.027 (0.023)	-0.048** (0.020)
Trained Entrepreneur	0.605*** (0.235)	0.286 (0.225)	0.116 (0.201)
Male Entrepreneur	-0.114 (0.227)	0.442* (0.229)	0.068 (0.204)
Family Ownership	-0.161 (0.275)	0.214 (0.320)	-0.421 (0.273)
Ln(SME size)	0.075 (0.104)	0.181 (0.112)	0.052 (0.098)
Sector of the SME	-0.094 (0.259)	-0.324 (0.251)	0.355 (0.221)
Financial barriers	-0.209 (0.232)	0.839*** (0.315)	0.050 (0.219)
Access to Information	0.685*** (0.245)	0.136 (0.244)	0.287 (0.213)
Membership	-0.028 (0.217)	-0.287 (0.215)	-0.433** (0.198)
Distance to market	0.034** (0.014)	0.059*** (0.016)	0.016 (0.014)
Location	0.517* (0.269)	0.035 (0.263)	-0.039 (0.233)
General support	0.325 (0.221)	0.300 (0.244)	0.597*** (0.228)
Adaptation assistance	0.226 (0.207)	0.064 (0.208)	0.608*** (0.190)
Constant	-2.350*** (0.716)	-4.714*** (0.940)	-1.240* (0.694)
Observations	296	283	296
District dummies	YES	YES	YES

Notes: Standard errors are in parentheses. ***, ** and * represent statistical significance of 1%, 5% and 10%, respectively. We employ separate probit regressions to estimate the coefficients for the three types of adaptation: financial, capacity and production adjustments. Source: Authors' own

Table A3: Future adaptation planning: probit regression

Variables	
Sustainable adaptation (est.)	0.125*** (0.041)
Reactive coping (est.)	0.069*** (0.025)
Lack of salience	-0.053 (0.063)
Lack of climate data	-0.168** (0.070)
Observations	293

Notes: Standard errors are in parentheses. ***, ** and * represent statistical significance of 1%, 5% and 10%, respectively. We employ a probit model instead of ordered probit by treating future planning with or without the help of external assistance as a single response. Source: Authors' own

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